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No. 402

IN THE

Supreme Court of The United States

October Term, 1969

UNITED STATES OF AMERICA,
Petitioner,

v.

SHELDON A. KEY, Trustee,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The order of the District Court for the Southern District of Indiana confirming the plan of reorganization (R. 58-63)[1] is not officially reported. The opinion of the United

[1] "R" references are to the separately bound record appendix.

States Court of Appeals for the Seventh Circuit (R. 74-80) is reported at 407 F. 2d 635. It affirmed the ruling of the District Court.

JURISDICTION

The judgment of the court of appeals was entered on February 27, 1969 (R. 81). On May 20, 1969, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to and including July 27, 1969, a Sunday. The petition for a writ of certiorari was filed on July 28, 1969 and was granted on October 20, 1969. The jurisdiction of this Court is conferred by 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Does the priority status of a tax claim of The United States vest in the Secretary of the Treasury the authority to defeat a plan of reorganization under Chapter X of the Bankruptcy Act by rejecting the same even though payment of the claim has been provided for pursuant to means authorized by Section 216(7)?

STATUTES INVOLVED

The pertinent provisions of the Bankruptcy Act, as amended, are Sections 199, 216, 221 and 236. The only statute involved in addition to the Bankruptcy Act is Revised Statute, Sec. 3466. The statutory provisions are set forth at pages 45 to 47 of the appendix to the Respondent's brief.

STATEMENT

The trustee (Respondent) has no objection to the United States' (Petitioner) statement (pp. 2-4, Petitioner's brief).

The trustee would elaborate on the government's statement of the case as follows:

When the debtor filed its voluntary petition in the District Court for a reorganization under Chapter X of the Bankruptcy Act, on May 3, 1954, the debtor was a general commodity carrier operating by authorization of the Interstate Commerce Commission over a network of regular routes bounded by the area included within a line extended between Milwaukee, Wis., St. Louis, Mo., Kahlo, Ill., Louisville, Ky., Pittsburgh, Pa., and points within forty miles thereof, Cleveland, Ohio, and Detroit, Mich.

The trustee filed his plan of reorganization on March 25, 1955, and the District Court approved the plan on April 5, 1955. Subsequently, the trustee modified the plan in 1956, and the plan as modified was approved on October 2, 1956, and confirmed on January 31, 1957. The modified plan, as confirmed, provided for payment in full or part of claims totalling in excess of $1,500,000, including the claim of the United States for taxes totalling $411,458.06. In brief, the plan provided for a transfer of assets to the reorganized debtor to be recapitalized in part through an underwriting agreement between the debtor and a third party whereby the latter would underwrite $1 Million of the sale of new securities of the corporation and guarantee the sale of assets up to $250,000.

The United States was classified as a Class 4 creditor under the 1956 plan and was to be paid 25% of its claim in cash on the date of consummation and the balance of said claim in four annual payments of 25% each, bearing interest at 6% per annum. The plan also provided that specified secured creditors in Classes 2 and 3 were to receive interest at the rate of 6% from July 1, 1957, to

payment. Cash payment in full was to be made on all wage claims, secured creditors, claims of governmental agencies other than for taxes and real property taxes. Other tax claimants, classified as Classes 5 and 6, received the same terms of payment as did the United States. Holders of freight and overcharge claims, on confirmation of the plan, were given a choice between 25% of their claim in cash or payment in full in the form of 5% in cash and 19 promissory notes, each representing 5% of the debt, to be paid over a period of time. The rights of the shareholders of the debtor were adjusted under the plan thereby permitting the shareholders to acquire shares in the new corporation by redemption of old shares plus cash. General unsecured creditors received a choice of 10% in cash of the face amount of their claims, on consummation, or one-quarter share of new preferred stock for each $100 in the principal amount of their claim.

The United States tendered a conditional acceptance of the plan in writing setting forth several conditions, among which was the condition that, through the District Director, it received the right under the order of confirmation to declare the entire balance due and payable on any default by the reorganized debtor in payment of its claim and collect such amount due in the manner as provided for in the Internal Revenue Code.

On January 31, 1957, the District Court confirmed the plan of reorganization, providing therein *inter alia* (1) the reservation of jurisdiction to enter orders from time to time aiding in consummation of the plan; (2) finding the debtor insolvent; (3) incorporating the conditions set forth by the United States in its conditional acceptance; and (4) directing the trustee to consummate the plan on or before June 17, 1957.

The date of consummation of the plan was subsequently extended, due to the complexity of financing agreements, through June 1, 1958. On June 1, 1958, the property and assets in possession of the trustee were vested in the reorganized debtor corporation, and the cash and shares of stock provided for under the plan were paid out as designated to the creditors involved therein.

On June 1, 1958, the reorganized debtor proceeded to operate its business without supervision of the trustee or reorganization court.

On December 6, 1961, the trustee filed his petition to declare the plan of reorganization substantially consummated and to direct a filing of his final report. At that time all claims in the proceeding had been adjudicated. The claim of the United States had been paid down pursuant to the plan, to a balance of $181,563.33, inclusive of principal and interest.

At or about the same time the reorganized debtor had entered into negotiations with Hennis Freight Lines, Inc. (hereinafter referred to as "Hennis"), a general commodity carrier doing business mainly between the southern states and the New York, Philadelphia, and New Jersey industrial centers, for a sale of its certificate of convenience and necessity issued by the Interstate Commerce Commission. On February 15, 1962, an agreement of sale was entered into between the parties providing for a sale of the Hancock operating rights to Hennis for the sum of $1 Million, inclusive of principal and interest, payable $300,000 within 90 days of approval and the balance in 78 equal monthly installments. The contract also provided in the event of cancellation of a portion of the Hancock operating rights by the Interstate Commerce Commission for a reduction in the purchase price in direct ratio to

the number of miles embraced in the cancelled rights. Pending the approval of sale by the Interstate Commerce Commission, Hennis agreed to lease the operating rights pursuant to temporary authority for the sum of $2,000 per month.

On March 5, 1962, before hearing on the trustee's petition was held, three creditors whose claims had arisen subsequent to June 1, 1958, filed a petition praying: (1) that the plan of reorganization be amended to provide for payment of creditors whose obligations arose subsequent to the confirmation of the plan; and (2) that the trustee be empowered to retake control and possession of the debtor. The petition alleged *inter alia* the insolvency of the reorganized debtor. On March 15, 1962, after due hearing, the District Court entered its order revesting the trustee with title to the property of the debtor and directing the trustee to proceed as though Chapter X proceedings had commenced.

Among the claims filed with the trustee after he reassumed possession of the property and assets of the debtor was that of the government in the total sum of $380,419.01, representing the balance due it under the plan confirmed in 1958 totalling $181,563.33, together with new liabilities incurred by the reorganized corporation, inclusive of principal and interest, totalling $197,975.40. The claim has since been reduced and allowed pursuant to stipulation in the sum of $375,386.55 (R. 71-73).

Subsequent to the return of the assets and property to the possession of the trustee, the District Court entered its order on August 10, 1962, affirming the contract of sale between Hennis and the debtor involving the sale of the debtor's interstate operating rights and authorizing the trustee to take all steps necessary to consummate the sale.

The application under Section 5 of the Interstate Commerce Act was referred to a hearing examiner who submitted his report on August 15, 1964, recommending that the sale transaction be approved providing, however, for a modification imposing certain restrictions on shipments originating from and destined to Detroit, Michigan.

The Interstate Commerce Commission issued its order approving the hearing examiner's report on March 11, 1965.

The trustee filed suit in the District Court to overrule the Interstate Commerce Commission. The three-judge court entered an order on January 12, 1967, sustaining the Interstate Commerce Commission.

Thereafter, Hennis insisted on a reduction in sale price pursuant to the terms of the contract. After extensive negotiations a modification of the original purchase agreement was entered into.

The modification provided for a purchase price to be paid by Hennis of $935,000 in lieu of the original $1 Million, payable as in the original agreement—$300,000 within 90 days of final approval and the balance of $635,000 by a note secured by a chattel mortgage on the operating rights payable in 78 equal monthly installments. The trustee agreed to submit a plan providing for payment of all administration and priority claims in full, without interest, and for settlement of all unsecured claims for 20% of the amounts due. The purchase price was to be further reduced by deducting therefrom any funds in excess of the amounts needed to satisfy the plan.

The proceeds from the sale of the operating rights under the modified agreement of sale, together with approximately $75,000 representing funds in the hands of the

trustee, formed the means of execution under the trustee's amended plan of reorganization as filed on June 23, 1967. The amended plan of reorganization classified the United States as a Class 2 creditor providing payment as follows:

> "A. Creditors in Classes 2, 3, 4, and 5.
>
> "Holders of the following claims, i.e. the United States with respect to all claims against the debtor inclusive of but not limited to taxes, The State of Indiana, Gross Income Tax Division for taxes arising under the Gross Income Tax Laws, The State of Indiana, County of Vanderburgh for personal property taxes and the State of Ohio, Department of Taxation for Highway Use Taxes shall be satisfied by the payment to said creditors of ten per cent (10%) of the amount of said claims, in cash, within six months from the date of confirmation of this plan of reorganization, and by the payment of the balance of said indebtedness in full, exclusive of interest, in seventy-eight equal monthly instalments, the first said instalment to be paid within six months after confirmation of the plan. Said instalment payments shall be secured by the assignment of note and chattel mortgage as herein after more explicitly set forth in the Means of Execution of this plan; and the rights of the creditors in the afore-mentioned classes shall be modified and altered accordingly." (R. 65).

Article VIII of the amended plan of reorganization provides security for the payment of the United States and other tax claimants by providing that Hennis will execute a note in an amount not to exceed $635,000, reduced by the amount in excess of the sum necessary to make the payments provided for under the plan.

The actual amount of the note has now been fixed in the sum of $600,968.16, representing the total amount of

the claims of the four tax creditors less the 10% to be paid on confirmation.[2] This note will be secured by a chattel mortgage on the operating rights. The aforementioned note and mortgage will be assigned by the debtor to a banking institution approved by the court as trustee for the benefit of the United States and the three other tax claimants. Hennis will make the prorated monthly payments totalling approximately $7,700 directly to the claimants rather than to the trustee.

In addition to providing for tax claimants and unsecured creditors, holders of claims for wages will be paid in cash within six months and the claims of various states for real and personal property taxes are to be paid within six months from the date of confirmation. No provision is made in the plan for stockholders, by reason of the insolvency of the debtor.

On September 7, 1967, the petition for approval of the agreement modifying the 1962 contract for sale of the debtor's operating rights to Hennis and approval of the amended plan of reorganization were brought on for hearing simultaneously. The court, after hearing the trustee's witnesses, Jesse L. Phipps, Vice President of Hennis (R. 29-34); Thomas W. Andrews, Vice President of McLean Trucking Company, Webster Division (R. 34-36); and Sheldon A. Key, trustee (R. 36-40); held that $935,000

2

Class 2, United States	$375,386.55
Class 3, State of Indiana, Gross Income Tax	31,218.91
Class 4, State of Indiana, Vanderburgh Co.	76,650.55
Class 5, State of Ohio, Highway Use Tax	184,486.39
	$667,742.40
Less 10%	66,774.24
	$600,968.16

was a fair price for the debtor's interstate operating rights and approved the agreement, to-wit:

> "ORDERED: That the modification agreement entered into between Hennis Freight Lines, Inc. and Sheldon A. Key, as trustee for Hancock Trucking, Inc., for the reduction of the purchase price relating to the sale of the interstate operating authority is approved;..." (R. 41-42).

On December 19, 1967, the District Court entered its order confirming the plan of reorganization, in part as follows:

> "11. That the provisions of Article VII, Section 199, and Article X of Chapter X of the said Act have been complied with.
>
> 12. That the said plan is fair and equitable, and feasible.
>
> 13. That adequate protection for the realization by the creditors in classes (2), (3), (4), and (5) is provided by the plan by securing the payment of their claims by an assignment of note and chattel mortgage on the operating rights to be transferred to Hennis Freight Lines, Inc., and that such method safeguards the interests of such creditors and equitably and fairly provides the protection for the payment of the claims of said creditors." (R. 62).
>
> • • •
>
> "17. That the debtor is insolvent." (R. 62).

There is no provision in the plan for any class of creditor to receive interest on its claim whatsoever.

SUMMARY OF ARGUMENT

Section 199 of the Bankruptcy Act outlines the priority of the government's tax claim in the Chapter X proceeding and Sections 216(7) and 221 establish a standard of

payment of such claim under the plan of reorganization.

The purpose of Section 199 is to insure the United States payment of all valid tax claims and claims for customs duties allowed by the District Court in a Chapter X proceeding whether the debtor is solvent or insolvent in the bankruptcy sense. This purpose is not inconsistent with the purpose of Revised Statutes Section 3466.

The Respondent-Trustee has never challenged the right of the United States to have its claim ranked as a priority claim and the right to have its claim paid as allowed in the proceeding. Such is the full "bundle of rights" accorded the Sovereign under the doctrine of *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) and *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510 (1940).

Since the plan provides for satisfaction of the foregoing "rights" of the United States, the rejection of the plan by the Secretary of the Treasury cannot block confirmation since there is no statutory directive to this effect.

Under the facts of this case, it is within the broad discretion afforded the court under Section 216(7) and 221(2) to treat the class of the United States' claim as any other class of non-assenting creditor and examine the terms of the plan to determine if adequate protection assuring satisfaction of all the United States' rights is provided therein. The District Court and the Court of Appeals found that the plan protected the United States' claim under Section 216(7). A fund is set aside for payment to the United States and no other creditor receives a share of that fund prior to the United States. The continued existence of the fund is assured by a chattel mortgage on property of the debtor valued in excess of the balance of the government's claim.

Neither the demand of the United States for exemption from application of 216(7), nor its demand for immediate cash payment is supported by any provision of the Bankruptcy Act.

Rather, traditionally, installment and postponed payments to creditors have long been accepted as proper to facilitate reorganizations.

The alternative demand by the United States for interest on postponed payments in a debtor relief proceeding is clearly prohibited by the strong public policy against payment of post petition interest on claims of taxing authorities. *City of New York v. Saper,* 336 U. S. 328 (1948).

The United States has no legitimate complaint that the provision in the plan for a payment to unsecured creditors of a 20% dividend dilutes its rights, or that junior creditors are receiving something of value at the expense of senior creditors, for two reasons:

(1) The 20% dividend to unsecured creditors is a compromise of their claims under the plan, since these creditors would receive larger percentages if the estate were liquidated in straight bankruptcy. The District Court is given broad discretion in approving such a compromise and payment throughout the Chapter X proceeding. *Case v. Los Angeles Lumber Products, Co., supra.*

(2) Payment to other creditors is not being made from the fund set aside for the United States, hence, it does not dilute the government's share.

The facts in this case clearly establish that the District Court did not abuse its discretion in confirming the plan, nor did the Court of Appeals err in affirming the order of the District Court. The plan is "fair, equitable and feasible" in all respects.

ARGUMENT

THE PRIORITY STATUS OF THE UNITED STATES GRANTED BY SECTION 199 IS NOT INCONSISTENT WITH NOR DOES IT EXCLUDE THE APPLICATION OF THE PROVISIONS OF SECTION 216(7).

Section 199 (11 U.S.C., Sec. 599) of the Bankruptcy Act provides that the Secretary of the Treasury may accept or reject a plan of reorganization. It further provides that no plan of reorganization shall be confirmed which does not provide for the payment of all claims of the United States except upon the acceptance by the Secretary of the Treasury of a lesser sum.[3]

---

[3] Sec. 199 of the Bankruptcy Act provides as follows:

"SEC. 199. If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court; *Provided*, That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed."

Revised Statutes Sec. 3466, 31 U.S.C. Sec. 191, provides for the priority status of all debts due the United States by an insolvent debtor.[4]

The Petitioner, United States, goes to great length in its argument to review the historical background of the right of the United States to priority. (Petitioner's Brief, pp. 8-25), and to state in its brief:

> ". . . that the United States is entitled to payment first if it insists upon it." (Petitioner's Brief, p. 13).

The trustee has never contended that the United States does not have priority, nor did the courts below. It is the assertion of the Petitioner that §3466 overrides the clear intention of Secs. 199, 216 and 221 of the Bankruptcy Act with which Respondent trustee takes issue.

It is best clearly stated by the Court of Appeals in the decision rendered below.

> "Within Chapter X, §§ 199, 216 and 221 are interrelated statutes and part of a studied statutory plan. Section 199 outlines the nature of the government's tax claim "priority", and two other sections establish an equitable standard to govern the method of payment. If, as the government would have us hold, § 3466 creates an absolute right to first payment in addition to full payment, there would be little need for §§ 199, 216(7) and 221. These sections apply specifically to Chapter X proceedings and should control

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[4] R.S. §3466: "Whenever any person indebted to the United States, is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

over the more general and conflicting direction of § 3466." (R. 79).

United States v. Anderson, 334 F.2d 111, 116 (CA-5, 1964), *cert. denied*, 379 U.S. 879 (1964), succinctly states what the trustee views as the relationship between Section 199 and R.S. § 3466:

> "Nor do we think that section 199 (quoted supra in n.5) is inconsistent with R.S. § 3466. Section 199 is applicable in the reorganization of solvent as well as insolvent corporations. It requires the consent of the Secretary of the Treasury to the confirmation of any plan of reorganization which does not provide for the payment of claims of the United States for taxes. This provision first appeared in the Act of August 29, 1935, 49 Stat. 965, 966, which amended former Section 77B of the Bankruptcy Act to give a first priority to tax claims of the United States. Its legislative history shows that its purpose was to insure full payment of taxes and customs claims in every reorganization proceeding, including those involving solvent corporations where R.S. § 3466 would not apply. See Senate Report No. 1386, 74 Cong., 1st sess." *United States v. Anderson*, 334 F.2d 111, 116 (CA-5, 1964)

The trustee concedes that no plan can be confirmed without acceptance by the Secretary of the Treasury if payment of a lesser amount due the United States is called for. This does not apply in the instant case. The plan of reorganization provides for payment of the entire claim due the United States.

The trustee concedes that as a claimant the United States must be classified in one or more separate classifications in any plan of reorganization by reason of the fact that Section 199 provides that if the United States is a creditor it shall be deemed affected and thus provisions for the acceptance by the Secretary of the Treasury are included.

The United States, however, insists that Section 199 places in the hands of the Secretary of the Treasury the power to veto any plan. Under the plain and usual language of the statute, the second proviso of Section 199; i.e., the Secretary of the Treasury may veto the plan, applies *if and only if* the first proviso providing for payment is not met.

The meaning of Section 199 is clear that if the government receives payment under the plan it has no right to block confirmation of the plan. To read the statute as providing the government with a right to payment and a right to veto the plan is to reach an absurd result. No creditor can expect more than full payment under a plan; once he is so provided, he has no standing to veto the plan. The alternative as hereto alluded is to give the government the ability of throwing corporations deliberately into bankruptcy at will through § 236 of the Act should the plan not please the Secretary of the Treasury's office, regardless if it provides payment or not and on whatever terms. The objective of this proceeding to reorganize a corporation is not that the major part of the assets go to one or two tax creditors and that the remaining creditors get nothing or very little.

In these instances the over-all public interest, i.e., interests of other creditors, can only be interpreted as being endangered by the pressure of the Sovereign for an unwarranted share of the available assets. The same danger to the public good is presented by the government's position in the case at bar.

> "Whether or not the business could be forced into liquidation, rather than reorganized, is thus a matter of complete indifference to the government. . . ." (Petitioner's brief p. 38).

Such a stand can only be termed one made in total disregard for the legislative history of Chapter X and its forerunner §77B and the statutory purpose of this amendment to the Bankruptcy Act. As documented in the Petitioner's brief on pages eight through eleven, R. S. §3466 has stood for since 1797 to assure the United States its share of the estate on liquidation of the assets of an insolvent person. R. S. § 3466 has been held to apply to all indebtedness due the United States by an insolvent debtor unless inconsistent with another federal statute also applicable to the interest of the United States. *United States v. Emory,* 314 U. S. 423, 433 (1941).

The purpose of R. S. § 3466 is to assure payment to the United States from estates of insolvent debtors. The purpose of Chapter X, as has long been recognized by this Court, is not to liquidate an insolvent debtor but rather to rehabilitate a corporate debtor in failing circumstances into a solvent entity. See, *Fidelity Assurance Assoc. v. Sims,* 318 U.S. 608, 617-622 (1943); 6 Collier, *Bankruptcy* para. 0.11, 116-119 (rev.ed. 1969); H.R. Rep. No. 194, 73d Cong. 1st Sess. 1-4 (1933).

The Respondent has no quarrel with the facts set forth in the "legislative history" portion of the Petitioner's brief (pp. 8-28) only with the opinions interjected therein and the conclusions drawn therefrom. The Petitioner correctly relates that the case law of federal equity receivership proceedings, which performed the function of enabling corporations to be reorganized prior to the §77B amendment, recognized priority to be given claims of the United States under R. S. § 3466 prior to unsecured creditors but behind costs of administration, wage claims and lien creditors. Blair, *The Priority of the United States in Equity Receiverships,* 39 Harv. L. Rev. 1 (1925).

Moreover, the Congress of the United States had no intention of destroying the priority of the United States' claims for taxes or customs duties and amended the act in 1935 to so specifically provide. 79 Cong. Rec., pt. 13, 14101, 14658 (August, 1935).

Contrary to the Petitioner's interpretation of history however, Chapter X was not the child of the equity receivership proceeding but rather a cure for its ills. *Duparquet Huot & Moneuse Co. v. Evans,* 297 U. S. 216, 218-219 (1936).

It was the intention of the legislature in propounding the corporate reorganization emergency legislature to alleviate as much as possible one of the major defects in the equity receivership proceeding—among others—the inability to deal with dissenting creditors. Under the equity receivership proceeding dissenting creditors had to be paid a *pro rata* portion of the debtor's assets. This payment had to be made by the new corporation and accomplished a drain on operating capital. See, Finletter, *The Law of Bankruptcy Reorganization,* 17-19 1939); 6 Collier, *Bankruptcy,* para. O.05, 61-68 (rev.ed. 1969). In a bankruptcy proceeding the dissenting creditors and stockholders could be bound by the terms of the plan regardless of their rights under the "obligation of contracts" and "due process" clauses of the Constitution. *Canada So. R. R. Co. v. Gebhard,* 109 U. S. 527, 537-538 (1883); *Campbell v. Alleghany Corp.* 75 F. 2d 947, 952-955 (CA-4, 1935), *cert. denied,* 296 U. S. 581 (1935). The policy of scaling down claims and binding dissenting minority creditors of all classes was reported to both houses by the Committees on the Judiciary in H. R. Rep. No. 194, *supra* at p. 3 and S. Rep. No. 482, 73rd Cong., 2d Sess. 5 (1934), to-wit:

> "The plan of reorganization shall include provisions modifying or altering the *rights of creditors generally or any class of them*, secured or unsecured, through the issuance of new securities of any character or otherwise. It may include provisions modifying or altering the rights of stockholders generally or any class of them, through the issuance of new securities of any character or otherwise." (emphasis, added).

The Act as drafted and passed gave effect to the desires of the Committees on the Judiciary to deal with dissenting creditors through 77B (e) (1) which provided for the necessity of approval of a plan by only two-thirds of the class and §77B (b) (5) which provided for treatment of dissenting classes in the same terms as present §§179 and 216(7). There was no provision in §77B which prevented the application of §77B (b) (5) to the United States it it should reject a plan. Nor, is there any provision in Chapter X which excludes the United States from the application of §216 (7).

The United States contends throughout its brief that priority means payment in cash at the time of confirmation or in the alternative, interest on the deferred installments. The trustee's position is that neither of these provisions is necessary to satisfy "payment" under Section 199 if adequate protection for the realization of the value of the claim of the United States against the property dealt with by the plan has been provided pursuant to Section 216(7), 11 U.S.C., Sec. 616(7). *Nowhere in its brief has Petitioner faced up to Section 216(7) of the Bankruptcy Act, which provides as follows:*

> "SEC. 216. A plan of reorganization under this chapter—
>
> • • •

> "(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;"

Thus, the basic problem is whether or not a conflict exists between Sections 199 and 216(7). The United States refuses to face this issue squarely and head-on. Inferentially, however, the point is raised by the United States, in asserting that by priority it is meant that all claims of the United States must be paid in cash before any other creditors receive any distribution.

The trustee is of the view that payment is equivalent to satisfaction which is consistent with the provisions for providing adequate protection for dissenting creditors pursuant to one or more of the means set forth in Section 216(7).

The United States Cannot Demand Cash Payment On Confirmation of the Plan

Chapter X is silent on the method of payment to be accorded creditors, but it appears from a reading of the statute as a whole and a review of the case law that no creditor, secured or unsecured, including the United States,

can demand cash payment on the date of confirmation or any other date, should the court approve a plan providing payment by another method.[5]

As a practical matter plans are often based on payment of creditors through cash flow from the debtor's rehabilitated business itself. Accumulation of sufficient income to satisfy claims often takes a period of time after confirmation of the plan. This period is determined by the plan, not by the creditors' demands. See, *In re Gibson Hotels,* 24 F. Supp. 859, 865 (S.D. W. Va., 1938); See also, Bernhardt, *Government Priority for Repayment of Monies Advanced To Contractors,* 20 J. Nat'l. Assn. of Ref., 35, 41 (1946).

Chapter X is silent in regard to the payment method of all claimants, including the tax claimant, thereby indicating that payment may be made by any method which is considered by the court to be "fair and equitable and feasible," under Section 221(2), 11 U.S.C., Sec. 621(2), of the Bankruptcy Act. Other chapters of the Act provide specifically that the government shall be paid in cash. In an ordinary bankruptcy proceeding under Section 64(a)(4), 11 U.S.C. Sec. 104(a)(4), it is specifically provided that the United States' claim for taxes shall have priority in advance of payment of dividends. Section 65(b), 11 U.S.C., Sec. 105(b), provides for payment of dividends only if the money in the estate is in excess of the amount necessary to pay priority debts. This can only contemplate cash after liquidation of the estate. Section 337(2) of Chapter XI, 11 U.S.C., Sec. 737(2), provides that the

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[5] 6A Collier, *Bankruptcy,* para. 10.05, 431 (rev. ed. 1969) postulates that the court may even provide for payment of costs of administration in part in securities. See also, *In re Parker Young Co.,* 15 F. Supp. 965, 971 (D.C. N.H., 1936).

debtor shall deposit sufficient funds to pay priority creditors before he can proceed with any plan of arrangement. Section 64 of the Bankruptcy Act is held applicable to Section 337(2) as explained in 8 Collier, *Bankruptcy,* para. 5.33, 703-704, as follows:

> "The debts given priority by clause (4) of §64a consist of nondischargeable taxes legally due and owing by the debtor to the United States or any state or any subdivision thereof. All the provisions of §64a (4) are applicable to Chapter XI proceedings, and the taxes therein specified therefore have priority in Chapter XI cases, and the debtor must deposit the money necessary to pay those taxes. The taxes which come within the priority conferred by §64a(4) are completely discussed in Volume 3, and that discussion is applicable to Chapter XI proceedings."

In contrast, Section 102, 11 U.S.C., Sec. 502, specifically provides that Section 64 shall not apply in Chapter X proceedings.

The government's right to payment in cash was touched on in the opinion of the District Court for the Southern District of New York in *In re Huyler's,* 107 F. Supp. 318 (1952), *aff'd. sub. nom., State of New York v. Feinberg,* 204 F. 2d 502 (CA-2, 1953). In that case the New York court approved a plan of reorganization involving an insolvent corporation under which the United States and other tax claimants received in satisfaction of their claims, subordinated debenture bonds bearing interest at 6%. The District of Columbia objected to the payment of its claim in the form of debentures and asserted its right to payment in cash. The court noted that the District of Columbia had no such right to cash payment, and in so holding said that the District of Columbia could assert no greater rights

than those of the United States, which were paid in like manner.

> "The Collector of Taxes for the District of Columbia objects to the plan to the extent that it will have 'to accept other than money' as payment for taxes due it. There is no legal merit to this objection. By virtue of the August 20 amendment to the plan neither this nor any other taxing authority will have to accept anything other than money as payment for the taxes due. The new form of subordinated debenture is in essence a method of postponing the full payment in money due, and during the period of postponement interest would be payable at the rate of 6 per cent. The distraint powers of all taxing authorities may be used in the event of a default under the subordinated debentures. The implicit assumption of this objection is that Congress, which enacted the District of Columbia Revenue Act, D.C. Code 1951, §47-101 et seq., intended a departure with respect to District of Columbia taxes from the policy which the Congress has embodied in the Bankruptcy Act. The assumption that the District of Columbia taxes are entitled to special treatment not accorded to taxes owing to the United States Treasury is completely unwarranted. In this connection it is interesting to note that the Treasury has filed no objection to its treatment under the plan." *In re Huyler's,* 107 F. Supp. 318, 323 (S.D. N.Y., 1952).

It should also be noted in this regard that bondholders asserted their rights to cash in *In re Radio Keith-Orpheum Corp.,* 106 F.2d 22 (CA-2, 1939), *cert. denied,* 308 U.S. 622 (1940), and the court held that the plan was not unfair as to these creditors because it did not provide for payment in cash.

Installment payments and postponed payments have long been accepted as a portion of workable plans to facilitate reorganizations prior to the existence of Chapter X or

even its forerunner, Section 77B. *In re Reiman*, 20 Fed. Cas. No. 11,673 (S.D. N.Y., 1874) *aff'd.*, 20 Fed. Cas. No. 11,675 (S.D. N.Y., 1875); *In re Kinnane Co.*, 221 Fed. 762, 766 (S.D. Ohio, 1915). See also, Note, 51 Harv. L. Rev. 1408, 1414-1415 (1938).

In the absence of specific provisions relating to the method of payment, the United States has no right to be treated in any different fashion than other claimants. See, *City of New York v. Saper*, 336 U.S. 328 (1948). In addition, the reorganization court has the authority to hear set offs and objections to the claim and accordingly expunge or scale down the tax claim, depending upon the facts surrounding the particular case. *Lyford v. City of New York*, 137 F.2d 782 (CA-2, 1943); *In re Pittsburgh Railways Co.*, 253 F.2d 654 (CA-3, 1958); *In re* 168 *Adams Bldg. Corp.*, 105 F. 2d 704 (CA-7, 1939), *cert. denied*, 308 U.S. 623, (1940).

In summary, therefore, even under a strict interpretation of rights accorded the United States by reason of its claim to priority, these rights do not encompass the right to cash payment on the date of confirmation.[6]

The Government Has No Right to Interest On a Tax Claim From the Date of the Filing Of a Petition Under Chapter X

The Petitioner points out quite correctly, on page 27 of its brief, that the United States is not entitled to post-petition interest from the debtor's estate in a Chapter X

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[6] As a practical matter, if the plan is repudiated and the estate is liquidated under Chapters I - VII of the Act, the United States would have no statutory authority to demand payment under § 64a until such time as the trustee collected all the assets of the estate. 3A Collier, *Bankruptcy*, para. 65.02, 2285.

proceeding. *United States v. Edens,* 189 F.2d 876 (CA-2, 1951), *aff'd per curiam,* 342 U.S. 912 (1952).

What the United States neglects to point out is the strong public policy in existence behind the rule disallowing the United States interest on its tax claim in a bankruptcy proceeding, be it straight bankruptcy, Chapter X or Chapter XI. *City of New York v. Saper,* 336 U.S. 328 (1948); *United States v. General Engr. & Mfg. Co.,* 188 F.2d 80 (CA-8, 1951), *aff'd per curiam,* 342 U.S. 912 (1952).

The leading case laying down the rule in this regard as it originally applied to straight bankruptcy cases is the opinion of the court by Justice Jackson in *City of New York v. Saper,* supra, in which the *ratio decedendi* is stated as follows:

> "More than forty years ago Mr. Justice Holmes wrote for this court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied. Sexton v. Dreyfus, 219 US 339, 344, 55 L ed 244, 245, 31 S Ct 256, 25 Am Bankr 363. Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims. Every logical implication from relevant provisions is to the contrary. Section 63(a) (1), 11 USCA §103(a) (5), 3 FCA title 11, §103(a) (5) allows interest only to that date on debts reduced to judgment after bankruptcy. No provision permits post-bankruptcy interest on other claims in general or tax claims in particular. Section 57(j), 11 USCA §93(j), 3 FAC title 11, §93(j) forbidding allowance of governmental penalties or forfeitures, permits allowance of losses sustained by the acts penalized, with actual costs and 'such interest

as may have accrued thereon according to law.' However, on its face this appears to delimit even such allowable debts as of the date of bankruptcy and to allow no more interest than does §63 with respect to the claims there specified.

Moreover, there is no interest except that which accrues according to law—it is exactly such interest that the 'fundamental principle' cuts off as of bankruptcy. Section 57(n), 11 USCA §93(n), 3 FCA title 11, §93(n), requires governmental claims to be proved in the same manner and within the same time as other debts and only for cause shown may a reasonable extention be granted. Tax claims are treated the same as other debts except for the fourth priority of payments, §64(a), 11 USCA 104(a), 3 FCA title 11, §104 (a), and the provision making taxes nondischargeable, §17, 11 USCA §35, 3 FCA title 11, §35. But each of these sections is silent as to interest.

The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankruptcy Act. To read into such a statute an exception to that rule would be unwarranted and, as an original proposition, we should decline to do so." *City of New York v. Saper*, 336 U.S. 328, 330-332 (1948).

In extending the rule to Chapter X in the case of *United States v. Edens, supra,* the Second Circuit Court of Appeals pointed out that the United States should not be permitted interest on its tax claims, since this would be a harsh penalty to be borne by other creditors and an undue benefit to the United States just because the proceeding is so long and protracted.

"The equitable considerations which justify denying post bankruptcy interest on tax claims in the case of reorganization proceedings are quite as strong as for denying it in straight bankruptcy proceedings. The real reason in either case is that the delay resulting from the institution of the proceeding should

> not be permitted to benefit one class of creditors at the expense of another, but that the rights of all should be determined as of the commencement of the proceeding. It is easy to see that post bankruptcy interest on tax claims in ordinary bankruptcy comes out of assets to which other creditors would be entitled." *United States v. Edens*, 189 F.2d 876, 877 (CA-2, 1951), *aff'd per curiam*, 342 U.S. 912 (1952).

Never was the reasoning in a case so pointedly applicable to another case as the reasoning in the *Edens* case, *supra*, is to the case at bar. If the United States were permitted interest on its claim from the date of confirmation to the date of full payment, the unsecured creditors would receive nothing. They, like the creditors in the *Edens* case, had no control over the period over which the administration of the estate runs; therefore, they should not be penalized by reason of a long, protracted court proceeding. No countenance will be given such a penalty by a court of equity.

It should be understood that interest on all of the claims of the United States has been computed and allowed to March 3, 1962, the date viewed as the commencement of the proceedings. See, *Clinton Trust Co. v. John H. Elliott Leather Co.*, 132 F. 2d 299 (CA-2, 1942).

The general principle applying to post-petition interest is well stated by Judge Kaufman of the Southern District of New York in *In re Huyler's* 107 F. Supp. 318, 324 (1952).

> "The face amount of the claims of the taxing authorities includes interest only to the day of the filing of the reorganization petition *and not for the period in which the bankruptcy is proceeding* and the established practice will be followed here." (emphasis added).

The rule disallowing the United States post-petition interest bars this interest through the proceeding, which would include the period between confirmation of the plan and consummation of the plan. This period is but a step in the administration of the debtor's estate. See, 6A Collier, *Bankruptcy,* para. 11.13, 666-667.

Public policy is so strong against permitting the United States to collect post-bankruptcy interest, directly or indirectly, that the bankruptcy court has been called on more than once since 1956 to correct the efforts of the United States to collect postbankruptcy interest on its claim after completion of the proceedings. Various ingenious methods have been conceived by District Directors in an attempt to recover that interest, but all have been thwarted by the bankruptcy court. See, *National Foundry Co. of New York v. Dir. of Int. Rev.,* 229 F. 2d 149 (CA-5, 1956).

In setting forth this rule disallowing post-petition interest, to which there are no exceptions it would appear the Supreme Court in the *Saper* case, *supra,* the *Edens* case, *supra,* and the *United States v. General Engrs. & Mfg. Co.* case, *supra,* was attempting to protect junior creditors in bankruptcy proceedings from receiving less than they would otherwise receive if interest on the United States' normally enormous claims was permitted. It is submitted that sometimes, in insolvency situations, the United States may be permitted to receive interest on its claim. The interest thus provided is by agreement between the parties or for the reason that some other class of creditor is afforded interest under the plan. No class of creditors is given interest under the plan at bar.

THE PRIORITY RIGHTS OF THE UNITED STATES ARE AFFORDED "FAIR AND EQUITABLE TREATMENT" UNDER THE SO-CALLED ABSOLUTE PRIORITY RULE

The rights of the United States to payment under the plan are afforded due protection under the absolute priority rule as incorporated in Chapter X through the "fair and equitable" provisions of Sections 216(7) and 221(2). The United States argues that the plan as promulgated does not satisfy the absolute priority rule.

The Petitioner's presentation on the so-called absolute priority rule most vividly points out the gross inconsistency running through the government's case. On the one hand the United States takes the position that one standard of priorities should apply to plans of reorganization of "solvent" debtors (§199) and a second to insolvent debtors (R. S. §3466). On the other hand the Petitioner's position is that portions of Respondent's plan violate the absolute priority rule which traditionally deals with interest of creditors vs. stockholders and creditor vs. creditor in the new reorganized corporation whose assets are to be valued on the basis of a "going concern."[7]

In this regard the Petitioner argues pertinaciously:

> "Each class of claims must be satisfied in full for the rights surrendered, in descending order, before the next junior class may properly be paid in the distribution. If junior creditors receive something of value at the expense of the senior creditors, the plan is not fair and equitable but 'comes within judicial denunciation'." (Petitioner's brief, p. 29).

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[7] See, Gilchrist, *Fair and Equitable Plan of Reorganization: A Clearer Concept*, 26 Cornell L Q. 592 (1941) *Cf. Northern Pacific Railway Company v. Boyd*, 228 U.S. 482 (1913); *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 130 (1939) *rehearing denied* 308 U.S. 637 (1939)

> "The present plan calls for such denunciation since it provides junior creditors with immediate, partial payment of their claims at the cost of requiring the government to accept delayed (and therefore discounted) payment of its claims and to bear the risk that the installment purchase contract will fail." (*id.* p. 36)

> "By requiring the government to accept installment payments, without interest, over a period of 78 months, the court has allotted it substantially less value than it would receive if it shared in the down-payment funds to the extent its priority suggests, or even equally with the other creditors. As senior creditor, it cannot be required to forego part of its rights, the right to be paid out of the first available funds, at least without receiving equivalent compensation in return." (*id.* p. 37).

The trustee agrees that the United States has a right to payment of the face amount of its claim in full. In order to violate the absolute priority rule, the Petitioner must be found to have surrendered this right under the plan without compensation for the right so surrendered. *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510 (1940); *Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, 317 U.S. 78 (1942). The plan at bar preserves the right of the Petitioner to receive payment in full and requires it to surrender no right it is legally entitled to.

> "Under the absolute priority rule, a plan is not 'fair and equitable' unless it provides participation for claims and interests in complete recognition of their strict priorities, and unless the value of the debtor's assets supports the extent of the participation afforded each class of claims or interests included in the plan. Any arrangement by which a junior class receives values allocable to a senior class 'comes within judicial denunciation.' Beginning with the topmost class

> of claims against the debtor, each class in descending rank must receive full and complete compensation for the rights surrendered before the next class below may properly participate. Thus the principle is applied as between senior or junior secured creditors, between secured creditors and unsecured creditors, between unsecured creditors and stockholders, between different classes of stockholders, and, of course, between secured creditors as a whole and stockholders." 6A Collier, *Bankruptcy,* para. 11.06, 613-617.

There is no provision in Chapter X which provides that the Petitioner must receive first proceeds coming into the estate. In fact, there are no provisions in any part of the Act that so provide, whether the proceedings be straight bankruptcy or Chapter XI, provided a fund is set aside to pay priority claims. See, Section 64, Section 337(2), Bankruptcy Act, 11 U.S.C., Sec. 104; 11 U.S.C., Sec. 737(2).

In the case at bar a fund has been set aside to pay the priority claims; as the estate receives payment, the United States receives payment. There is no other creditor being paid out of that portion of the fund designated to go to the United States before it is paid.

The United States contends that the payment to unsecured creditors is at the expense of a senior class, i.e., the United States—the contrary is true. It is the junior class which is giving up rights.

The plan is actually a plan of liquidation. It is not different in effect than the plan considered in *In re Capitol Foundry Corp.,* 83 F. Supp. 413 (E.D. N. Y., 1949), wherein the court determined the plan to be fair, equitable and feasible, which did not provide for interest on the claims of the United States even though general creditors received cash dividends under the plan.

The modified contract of sale indicates that the original $1 Million to be paid by Hennis to the debtor for its operating rights has now been set at $935,000, to be paid over a six and one-half year period.

If the funds were collected by the trustee and distributed in order of bankruptcy priority (assuming an adjudication under §236 and application of Section 64), and if distribution were ordered as funds received, the United States and other tax claimants would not receive their full principal amounts until four and one-half years later.[8]

The general unsecured creditors would thereafter receive a dividend of approximately 26-32%, dependent upon

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[8] The calculation is based on cash in the hands of the trustee of $75,000; payments made by Hennis under the contract to purchase operating rights of $300,000 within 90 days and the balance of $635,000 in 78 monthly installments; and costs of administration of $90,000 maximum:

Total funds in the estate:		
Procured from sale of operating rights		$ 935,000
Cash in hands of trustee		75,000
Total		$1,010,000
First distribution — 90 days:		
(a) Funds available		
Received from Hennis within 90 days		$ 300,000
Funds in hands of trustee		75,000
		$ 375,000
Less administrative expenses		(90,000)
Available for distribution:		$ 285,000
(b) Priority claims		
64(a)(1) Wages		$ 14,872.44
64(a)(5) Taxes		682,063.14
		696,935.58
(c) Remaining Tax claims after 1st distr.		$ 411,935
(d) Monthly payments from Hennis	$8,141.00	
Accumulated after 6 months —	48,846.00	
Second distribution—6 months after bankruptcy		48,846.00
		$ 363,089.00
Subsequent distributions—6 month intervals of $48,846 each (total of 8)		390,768.00
Balance accrued for general creditors		$ 27,679.00

the final costs of administration. Thus, the general creditors have agreed to scale down their equity from 26-32% to 20%.[9]

Nothing has been taken from the United States. It receives at the same time as the unsecured creditors receive their dividends the full value of its claim in the form of an assignment of note executed by the purchaser of the operating rights and secured by a chattel mortgage on property whose value is far in excess of its claim with provisions for payment in a manner consistent with which it would be paid in liquidation in straight bankruptcy.

Moreover, it is within the power of the trustee to compromise and pay claims during the proceedings or in the plan of reorganization. In *Case v. Los Angeles Lumber Products Co., supra,* the Supreme Court pointed out that compromise and settlement of claims is not only an allowable procedure in reorganization cases, but is often a sensible and desirable course to pursue. A compromise may be effected separately during the proceedings or in the body of the reorganization plan itself. *In re Paramount Publix Corp.,* 7 F. Supp. 988 (S.D. N.Y., 1934); *In re Kalamazoo Bldg. Co.,* 21 F. Supp. 852 (W.D. Mich., 1937); *In re Chicago Rapid Transit,* 196 F. 2d 484 (CA-7,

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[9] Assuming administration expenses of $90,000 after payment of priority creditors explained in fn 8, *supra,* $223,065 would remain for payment to general creditors whose claims total $842,640.75. A dividend of 26% would therefore be paid.

Total assets in the estate	$1,010,000.00
Less costs of administration	(90,000.00)
	$ 920,000.00
Less total priority claims	696,935.00
Available for general creditors	$ 223,065.00

As the costs of administration are decreased, the dividend to general creditors increases proportionately. If costs of administration are $40,000, the dividend would be 32%. The general creditors would have to wait 6½ years for full payment of their dividends.

1952); *In re Associated Gas & Elec. Co.*, 149 F. 2d 996 (CA-2, 1945), *cert. denied*, 326 U.S. 736 (1945). The agreement in the plan to pay general unsecured creditors 20% of their claims in a compromise with that class, since as pointed out above, if the estate were liquidated, in all probability these creditors would receive 26-32% of their claims. The trustee had the power to effect a settlement of these claims at any point in the proceedings prior to submission of the plan, or in the plan itself. Such compromise, if found in the best interests of the estate, must be approved by the District Court. Approval involves the exercise of judicial discretion and will not be disturbed on appeal except for abuse.

In attacking the plan by asserting that it violates the absolute priority rule, the United States omits to explain fully that such rule is one of equity administered by a court of equity. See generally, *Bank of Marin v. England* 385 U.S. 99 (1966).

The rule is a flexible one for two reasons: (1) the reorganization court has a duty to protect all creditors regardless of priority, *In re Atlas Pipeline Corp.*, 39 F. Supp. 846 (W.D. La., 1941); and (2) its application depends on the facts of the case, *Consolidated Rock Products v. Du Bois:*

> "Practical adjustments, rather than a rigid formula, are necessary. The method of effecting full compensation for senior claimants will vary from case to case." *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 529 (1940).

Collier defines the flexibility which the principle has gained through application as follows:

> "But even this 'fixed principle,' like other matters of classification, is subject to the doctrine that the re-

> organization court, acting as a court of equity and to prevent injustice, unjust enrichment or the like, may subordinate or postpone or separately classify for different treatment particular claims of a certain group, or subordinate a certain class or classes that would not otherwise be prior, on the basis of equitable considerations invoked by the facts present." 6A Collier, *Bankruptcy,* para. 9.10, 214-215.
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> See also; *In re Peyton Realty Co.,* 18 F. Supp. 822 (E.D. Pa., 1936); *Downtown Inv. Ass'n v. Boston Metro Bldg.,* 81 F.2d 314, 323 (CA-1, 1936); *In re Central Forging Co.,* 38 F. Supp. 18 (M.D. Pa., 1941).

Almost without exception the cases dealing with legitimate complaint of violations of the absolute priority rule under Chapter X involve situations where secured creditors who have rights by contract find these rights flagrantly violated in that interest rates on bonds and notes are reduced under the plan, and the terms for maturity of these obligations are extended, while junior creditors and stockholders receive some compensation which properly belongs to the senior creditor by contract. In addition to the cases cited by the United States, which involve bondholders under Chapter X, a bondholder under the railroad reorganization provision of the Bankruptcy Act, and a stockholder under Chapter X, to-wit: *Consolidated Rock Products Co. v. Du Bois, supra; Group of Institutional Investors v. Milwaukee Railroad Co.,* 318 U.S. 523 (1943); *Petition of Portland Electric Power Co.,* 162 F. 2d 618 (CA-9, 1947), *cert. denied,* 332 U.S. 837 (1947), The following examples of flagrant violations of the rule are given:

> Where a group of nonassenting bondholders were afforded a reduction of interest paid on their bonds under the plan and extension of the maturity date of the bond, coupled with reduction of the principal amount of the bonded indebtedness of some $26,000.

Francisco Bldg. Corp. v. Batson, 83 F.2d 93 (CA-9, 1936).

Where the class of non-assenting bondholders were asked to give up interest under the bond and assent to a seven-year extension of the maturity of said bonded indebtedness. *In re Lorrain Castle Apartments Bldg. Corp.,* 149 F.2d 55 (CA-7, 1945), *cert. denied,* 326 U.S. 728 (1945).

Where a plan of reorganization provided that first mortgage bonds be reduced by one-half of their principal amount and that equity thereby created be represented by issuance of new preferred and common stock to be shared by general creditors and present shareholders coupled with a provision for elimination of past-due interest on the bonds. *Day, Meyer, Murray and Young,* 93 F.2d 657 (CA-2, 1938).

See also, *In re Wilton Realty Corp.,* 30 F. Supp. 486 (E.D. Mich., 1938), *aff'd per curiam,* 106 F.2d 1022 (CA-6, 1938), *cert. denied, sub. nom., Wilton Realty Corp. v. Weadock,* 308 U.S. 626 (1940).

It is illustrated from the above-cited cases that the plans which have met destruction on the rock of the absolute priority clause have, without exception, involved a decrease in the payment which the senior creditor involved had a right to by reason of his contract with the debtor.

The United States asserts that the failure to pay the government its full claim in a shorter period does not result from a shortage of funds and that accordingly it is entitled to receive equivalent compensation in the form of interest for the delay imposed. (Petitioners brief, p. 27)

As heretofore indicated, funds would not be available to satisfy the claims of the government for more than four and one-half years (Fn. 8). Thus, the interest which the United States should be entitled to for equivalent com-

pensation, if at all, should amount to no more than $6,492.00.[10]

But no interest at any rate is being paid to other classes of creditors, including other tax claimants who would share an equal priority in straight bankruptcy. An analogous situation is found in *State of New York v. Feinberg,* 204 F.2d 502 (CA-2, 1953). The State of New York contended it was entitled to 9% interest on the debentures given to satisfy its claim, as the statutory rate to which it was entitled, and thus required to assure it equivalent compensation under the absolute priority rule. The Court in overruling the objections stated at p. 503:

> "... 'Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest'...."
>
> "Hence, Judge Kaufman was quite within his power in allowing the state here only such interest as other bondholders of like class were to receive."

The District Court was aware that the absolute priority rule is governed by the equities of the particular case, as set forth in part at the hearing on confirmation of the plan on December 8, 1967:

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[10] If payment were made first to the United States, at the end of 4½ years it would have received its full claim (Fn. 8, supra). Under the plan at the end of 4½ years, assuming no acceleration of payment of the Hennis note, the United States will have received 72.3% of its claim (54 installments of $4,332.00 or 1.15% each, plus the original 10% at confirmation). Thus, at the end of 4½ years, a principal balance of $103,919.90 would be owing the United States. Allowing 6% interest on future payments, allocating the monthly payments to principal and interest results in an interest load of $6,492.00.

"THE COURT: I don't want—Mr. Boyle, I don't want the impression to be gained that this is to be the rule as far as this particular court is concerned. There may be many, many cases in the future where I would not pursue this course. This case has been pending a long time, and many, many of the smaller creditors have waited a very, very long time, and I have been trying to weigh the equities, and this is an equitable proceedings even though it's governed by statute. I have been trying to weigh the equities between following the course that the Government would have the Court follow and following the course that the Court has chosen to follow, and I still believe that the factors weigh so heavily in favor of the Court confirming the Plan to get this thing closed, that the Court would not be doing what it thinks it should be if I were to go the other route." (R. 56-57).

Even under the strictest interpretation of the absolute priority rule, the plan at bar violates none of the United States' rights. It is submitted that the plan would indeed be inequitable if it were to provide interest for the United States' claim out of a fund which rightfully belongs to unsecured creditors.[11]

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[11] If the United States and the other three tax claimants in Classes 3, 4, and 5 were allowed 6% interest as demanded by the United States, this would amount to approximately $120,000. This added to the estimated total cost to Hennis exceeds the maximum amount which they are required to pay, bringing the total cash to $1,045,000.00, or in the alternative, deducting the excess from the fund allocated to the general creditors.

	Am't of Claim	Cash Distr.
Est. Administration Costs	$ 60,000.00	$ 60,000.00
Class 1, Wages	14,872.44	14,872.44
Class 2, United States	375,386.55	375,386.55
Class 3, Indiana Gross Income	31,218.91	31,218.91
Class 4, Vanderburgh County	76,650.55	76,650.55
Class 5, Ohio Highway Use Tax	184,486.39	184,486.39
Class 6, Misc. taxes	14,320.74	14,320.74

continued on p. 39

THE PLAN PROVIDES ADEQUATE PROTECTION FOR THE PAYMENT IN FULL OF THE UNITED STATES AS A NON-ASSENTING CREDITOR, THEREFORE THE PLAN CAN BE CONFIRMED OVER THE REJECTION OF THE PLAN BY THE PETITIONER AS A CLASS.

Since the plan provides payment in full of the face amount of the claim of the United States, its rejection of the plan can be treated as a rejection by any other class of creditor, giving the District Court the right to examine the plan as to adequate protection under Section 216(7). Section 216(7) of the Bankruptcy Act authorizes four alternative methods of going forward with a reorganization plan without the assent of an affected class, to-wit:

> "(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such

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Footnote #11 continued:

Class 7 Personal Injury	1,119.42)		
Class 8 Cargo Loss & Damage	38,240.06)	842,640.75	168,528.15
Class 9 General	803,281.27)		
Total Cost Under Plan			925,463.73
Estimated Interest			120,000.00
Total Requird			$1,045,463.72
Maximum Cost to Hennis	$935,000.00		
Cash Available	75,000.00		
	$1,010,000.00		

sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;"

Here, again, Chapter X is silent as to the exclusion of the United States from the application of this provision; therefore, it can be assumed that the provision is applicable under the rule that tax claimants will be treated as other claimants unless there is specific provision excluding them. *City of New York v. Saper, supra.*

For a general review of the legislative history and court decisions diluting the priority treatment of taxing authorities in bankruptcy practice, seen generally, *In re Halo Metal Products v. Randall,* C. C. H. 1969 Stand. Fed. Tax Rep. (Cas. No. 17608) para. 9123 (CA-7, 1969).

It is the position of the trustee that the means of execution of the plan, as provided under Article VIII (R. 67-68) provides adequate security to the United States as required under the cases interpreting Section 216(7).

It is submitted that the cases interpreting this section are few, since generally if the plan is found fair and equitable by the court; creditors have assented to the plan.

Section 216(7) provides the court with statutory matter for dealing with irate or recalcitrant creditors when the court in its discretion deems the plan as satisfying the fair, equitable and feasible provisions of Chapter X. At that point in the proceeding, the court usually requests that the trustee amend the plan to provide adequate protection for the recalcitrant creditor. In the case at bar, the plan had a built-in provision which satisfied the requirements of Section 216(7).

"The adequate protection for the realization by them (the United States) of the value of their claims against the property dealt with by the plan and affected by such claims . . . "has been provided in this instance (a) by the transfer or sale of the operating rights of the debtor, its substantial asset, subject to the claims of the dissenter in the form of a chattel mortgage for the balance due and (b) by a sale of property (the operating rights) at not less than a fair upset price ($935,000.00) and a transfer to the proceeds of sale, the government receiving 10% of the immediate cash and an assignment of the moneys due.

It would appear that all of the cases involving Sections 216(7) (a) and (b) relate to specific property to which specific claims have attached, the holders of such claims being mortgagees, bondholders or mechanic's lienors.

In re Englander Spring Bed Co., 17 F. Supp. 15 (E.D. N.Y., 1936), *aff'd per curiam*, 86 F. 2d 998 (CA-2, 1936) (involving mortgagees); *In re Central Forging Co.*, 38 F. Supp. 18 (M.D. Pa., 1941) (involving bondholders); *cf. Francisco Bldg. Corp. v. Batson*, 83 F. 2d 93 (CA-9, 1936).

In this instance the claim of the United States is not secured by any specific property, it is at most a general claim against all assets. Thus, the ordinary marshaling of assets should be sufficient to protect its priority. The Court in granting equitable relief has thus set aside under the provisions of Section 216(7) (a) or (b) sufficient property or proceeds to satisfy the requirements thereof.

If this appears too novel a situation to fall within the meaning of Section 216(7) (a) or (b), then certainly this is *the* case for which Section 216(7) (d) was intended.

As stated in 6A Collier, *Bankruptcy*, para. 10.17, 490-491 (rev. ed. 1969), in speaking of Section 216(7) (d):

> "It has been said that these methods, properly speaking, are not 'methods' at all, but merely empower the judge, who must approve and confirm the plan, to approve any means of treatment which under the particular circumstances 'equitably and fairly' affords adequate protection to the dissenters. Even though this may be a proper characterization, the provisions are not to be read out of the statute because of it. Admittedly, the potentialities of paragraphs (7) (d) and (8) (c) are difficult to define, but there seems to be little reason why they should not remain effective as possible alternatives to encompass the largely unforeseen case."

We submit that the instant plan is one which fits the shoe of special circumstances described in *Texas Hotel Securities Corp. v. Waco Development Co.*, 87 F.2d 395, 400 (CA-5, 1936); *cert. denied*, 300 U. S. 679 (1937), *rehearing denied*, 301 U. S. 713 (1937), in commenting on the forerunner clause in 77B:

> "There may be other cases of special circumstances in which adequate protection for realization of value can be worked out as contemplated by subparagraph(d)."
>
> See also, *National City Bank of New York v. O'Connell*, 155 F. 2d 329 (CA-2, 1946).

In this regard it should be noted that under Section 221 of the Act the District Judge is given broad discretion in weighing the facts and circumstances, in determining if the plan "satisfies" the absolute priority rule as well as Section 216. 6A Collier, *Bankruptcy*, para. 11.02, 581-582, sets forth the rule in this regard as follows:

> "The judge of the reorganization court is empowered to confirm a plan only 'if satisfied' that the conditions stated in §221 have been complied with. The words 'if satisfied' vest a broad discretion in the judge." See generally, *In re Waern Building Corp.*, 145 F.2d 584 (CA-7, 1944), *cert. denied*, 324 U.S. 871 (1945).

The United States in its brief implies that the purchaser may not be financially strong enough to see the purchase through to its conclusion or that the value of the operating rights might deteriorate.

The United States argues, on p. 38 of its brief, as follows:

> ". . . There is the least possible basis for requiring the government to assume any risk in this case, for the debtor here is no longer operating its business."

The applicable reply to such a position is, perhaps, the overused retort, "Life itself is a risk."

The District Court was well aware of the lengthy hearings before the Interstate Commerce Commission, the hearing examiner's report of March 26, 1964, and the approval by the Interstate Commission of said report recommending the sale of the operating rights on March 11, 1965. Such approval had necessarily to concern itself with the ability of the purchaser to pay and the value of the rights. I.C.C. Docket # MC-F-8117, Finance Docket #22243.

At the hearing on approval of the plan held on September 7, 1967, and the hearing on confirmation held December 8, 1967, the District Court had before it both evidence of the ability of the buyer, Hennis, to make payments under the modified agreement of sale and the ability of the estate to meet all payments as set forth under the plan of reorganization.

The evidence before the court clearly establishes that the value of the interstate operating rights transferred by the debtor to Hennis is not less than $850,000 (R. 30-33, 34-36); that its value has increased over the years; and that the income from the sale of these operating rights will be sufficient to assure payment to the government of its claim from the fund comprised of payments made under this agreement. (R. 31-34, 36-39).

The record is sufficient to support the finding of the court that adequate protection is provided the United States for the realization of its claim from the property dealt with and to provide protection for the aforesaid dissenting claimant.

CONCLUSION

The trustee's plan is fair, equitable and feasible. The order of the District Court confirming said plan should be upheld.

Respectfully submitted.

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APPENDIX

Revised Statutes:

SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U.S.C. 191.)

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]:

SEC. 199. If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall

fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed. (11 U.S.C. 599.)

SEC. 216. A plan of reorganization under this chapter—

(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

(2) may deal with all or any part of the property of the debtor;

(3) shall provide for the payment of all costs and expenses of administration and other allowances which may be approved or made by the judge;

* * * * *

(5) shall specify what claims, if any, are to be paid in cash in full;

* * * * *

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of

the particular case, equitably and fairly provide such protection;

• • • • •

(11 U.S.C. 616).

SEC. 221. The judge shall confirm a plan if satisfied that—

(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

• • • • •

(11 U.S.C 621).

SEC. 236. If no plan is proposed within the time fixed or extended by the judge, or if no plan proposed is approved by the judge and no further time is granted for the proposal of a plan, or if no plan approved by the judge is accepted within the time fixed or extended by the judge, or if confirmation of the plan is refused, or if a confirmed plan is not consumated, the judge shall—

(1) where the petition was filed under section 127 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

(2) where the petition was filed under section 128 of this Act, after hearing upon notice to the debtor, stockholders, creditors, indenture trustees, and such other persons as the judge may designate, enter an order either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act, or dismissing the proceeding under this chapter, as in the opinion of the judge may be in the interests of the creditors and stockholders.

(11 U.S.C. 636)